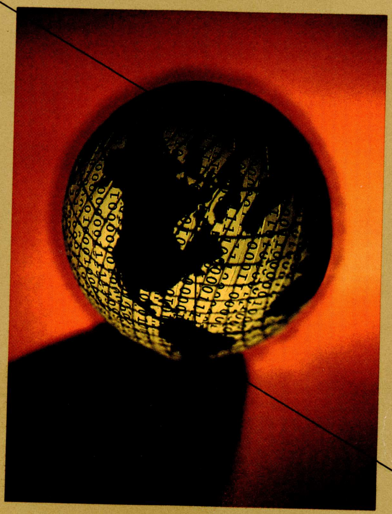
ANNUAL REPORT



1993

NETWORK GENERAL CORPORATION

PROFILE

Network General Corporation, founded in 1986, is a leading developer of software-based products designed to increase the performance and effectiveness of networks. The Company's award-winning products include the Distributed Sniffer System with Expert Analysis and the Expert Sniffer Network Analyzer for local area and internetworks, as well as an array of troubleshooting tools for wide area networks. Network General, with its long history of excellence and experience in network management, is well positioned to provide its customers with a wide range of products and services that support complex network computing environments.

CONTENTS

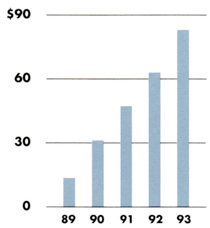
FINANCIAL HIGHLIGHTS

(In thousands, except per share amounts)	**1993**	1992	1991	1990	1989
Revenues	**$83,294**	$63,145	$47,831	$31,593	$14,249
Net income	**10,285**	8,485	6,652	5,855	2,696
Earnings per share	**.55**	.53	.43	.41	.25

Amounts for fiscal 1993, fiscal 1992 and fiscal 1991 have been restated in order to comply with Statement of Position 91-1. Fiscal 1990 and fiscal 1989 have not been restated. The cumulative effect of the change in accounting method for the years prior to fiscal 1991 was an $822,000 reduction to net income, which is reflected in fiscal 1991 results.

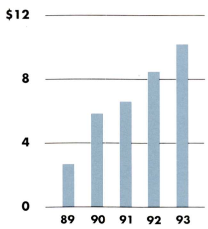
Revenues

(Dollars in millions)



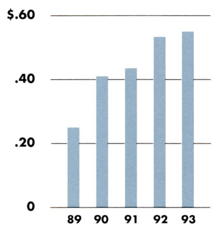
Net Income

(Dollars in millions)



Earnings per Share

(Dollars)



We are pleased to report that fiscal 1993 was Network General's seventh consecutive year of growth. Equally important, we continued to refine the strategies and make the investments that will carry the company into the future. We focused on providing network management applications, developing and introducing advanced technologies, building our management team, and expanding our direct presence in major U.S. and international markets. As a result, we believe Network General is well positioned to reach its potential in the marketplace.

Focusing on financial results

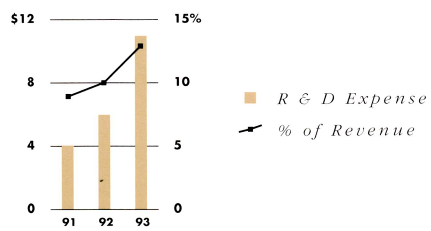
In fiscal 1993, we posted record sales and profits, and grew in every aspect of our business. Fiscal 1993 revenues were $83,294,000, up 32% from $63,145,000 in fiscal 1992. Net income was $10,285,000, a 21% increase from the $8,485,000 reported in the previous year. Earnings per share in fiscal 1993 totaled $0.55 per share, a 4% increase from the $0.53 per share in fiscal 1992.

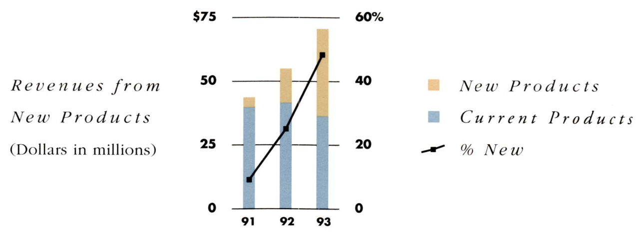
The relative flatness in earnings per share was primarily due to the public stock offering in April 1992, which increased the number of common shares outstanding by 18%. However, earnings results for the year generally did not meet our expectations because of slower than expected growth in sales of the Distributed Sniffer System (DSS) product line. Based on Network General's historically high rate of growth, we increased sales and R&D expenses in fiscal 1993 to take advantage of the opportunity we saw in DSS. Going into fiscal 1994, we have taken specific measures to control hiring and discretionary spending with the objective of growing earnings faster than revenues.

At the same time, we continue to make investments to support growth in coming years. For example, expenditures on research and development totaled $11,106,000 in fiscal 1993, an increase of 72% over fiscal 1992; this investment reflects our emphasis on developing new products and technologies. One result of this important component of our strategy is that the percentage of revenues from new products has risen steadily since 1991.

Finally, because of our recent public stock offering and positive cash flow, Network General's financial position has never been stronger. Cash plus short- and long-term investments totaled $89,935,000 at the end of fiscal 1993. These financial resources provide a solid balance sheet foundation for funding future activities.

Research and Development Expenses
(Dollars in millions)





Focusing on products and services

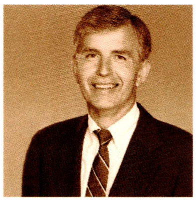
We successfully introduced both new and enhanced products in every quarter of the past year. We extended the range of our products, increased their value, and opened new markets in both our systems and tools product lines. This achievement is the direct result of investments made in product development in 1991 and 1992, and is vital to maintaining our position as a market leader in network management applications.

We focused our product development efforts on two major technological areas: expert network analysis and centralized network management systems. As enterprisewide networks grow, companies face increasing network complexity and shrinking network management resources. In March 1993, we addressed these trends by introducing the Distributed Sniffer System with Expert Analysis. DSS with Expert Analysis combines automatic, real time expert analysis with centralized network management to help increase the productivity of network managers. By helping organizations gain control over their expanding enterprisewide networks, DSS with Expert Analysis is well positioned to benefit from current market conditions.

In August 1992, we entered the UNIX market with the release of SniffMaster for X (SM/X). SM/X makes our technology available to users of UNIX network management systems and expands our base of potential customers. Network managers can now access the Distributed Sniffer System from their Sun workstations, X-Window-based workstations, or X-terminals.

SM/X also represents the first step in our long-term strategy to integrate the Distributed Sniffer System with network management platforms such as those from IBM, Sun Microsystems, Hewlett-Packard, and Novell. By making information gathered by the Distributed Sniffer System available to integrated network management systems, we will help customers attain a seamless network management environment.

On the tools side of our business, we began shipping the Expert Sniffer Network Analyzer in June 1992, providing managers with a new way to look at their networks. The Expert Sniffer looks at the consequences of network complexity, interpreting network problems in the context of how they affect users. In response to a growing need for analysis products that optimize the productivity and hard-dollar costs of internetworks, we extended our expert systems technology to that



LESLIE G. DENEND

market with the Expert Sniffer Internetwork Analyzer in March 1993.

In June 1992, we shipped the FDDI Sniffer Network Analyzer for 100 Mbps FDDI (Fiber Distributed Data Interface) networks. Intended for network managers, field service engineers, and developers, the FDDI Sniffer Analyzer is the latest extension of Network General's goal of delivering tools to solve problems on enterprisewide networks. Because of this commitment, the Sniffer family continues to lead the industry in providing management solutions for multitopology networks.

We added to our array of WAN analysis tools with the release of the LM2000 WAN Analyzer in September 1992. Addressing the needs of wide area network managers, the LM2000 supports traditional networks such as async, X.25, SNA, and T1, as well as today's new high-speed networks such as frame relay.

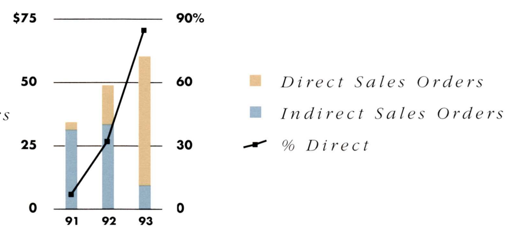
The explosive growth and complexity of networks have put a severe strain on the ability of organizations to identify qualified network management personnel. To address this issue we joined together with Hewlett-Packard, Wandel & Goltermann, ProTools, Inc., and AG Group, Inc. to establish the Certified Network Expert (CNX) program. The goal of the CNX program is to create an industry-wide standard for testing and certifying personnel in network analysis and troubleshooting. The CNX program, announced in January 1993, has already generated considerable interest in the industry, and we anticipate that additional network analysis vendors will join our efforts.

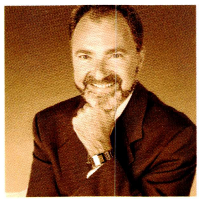
Focusing on sales channels and organization

One of our major goals last year was to build a direct U.S. sales force. We began shifting from manufacturers' representative firms to a direct sales force more than two years ago when we released our Distributed Sniffer System. As a result, we have increased our ability to serve Fortune 500 accounts and generate larger systems sales. Greater control over our domestic sales channel has also allowed us to get closer to our customers, and be more responsive to their needs in the quickly shifting network management market.

Internationally, we are increasing our local presence in major markets. We took the first step of our strategy to expand sales coverage and customer services in Canada by signing an exclusive distribution agreement with

Direct vs. Indirect Domestic Sales Orders
(Dollars in millions)





HARRY J. SAAL

Atelco Limited. This strategic relationship gives us a focused sales force and will provide greater opportunity for rapid growth and increased market penetration. In Europe, we established country managers in France and Germany to better focus our efforts in each of these markets. In Asia, we signed new distributors in Japan, Malaysia, Hong Kong, Korea, and the Philippines. During the coming year, we will continue to add to our direct presence in major international markets.

We continued to build our organization by strengthening our executive management team. Three senior executives joined Network General this year, each bringing experience that is invaluable as we build for the future. Les Denend, formerly President of Vitalink Corporation, was appointed Senior Vice President, Products, and was recently named President and Chief Executive Officer. Carl Goldman joined as Vice President, MIS and Manufacturing, and Peter Boot as Vice President, International Operations. We also promoted two individuals within the organization: Dick Lewis was promoted to Vice President, U.S. Sales, and Jim Pante to Vice President, European Operations.

Focusing on our strengths

We are proud that the industry has recognized our product leadership with the awards listed on the inside front cover of this report. For Network General, these product awards represent the highest acknowledgment of our efforts. We are especially proud of the awards based on readership surveys which indicate that users regard our products as the best in their class.

Focusing on our strengths is an important part of our strategy. Our expertise in helping people manage complex networks is unique in the industry, and is a key competitive advantage. The pages that follow illustrate specifically how we have helped four world-class organizations meet the challenge of network complexity.

We have many people to thank for contributing to our success this year. Our dedicated employees and strategic business partners have helped create an environment that fosters innovation and creativity. Our customers have provided loyal support and valuable input. And your support as shareholders has enabled us to begin realizing the potential of this market. With your continuing support we look forward to the year ahead.

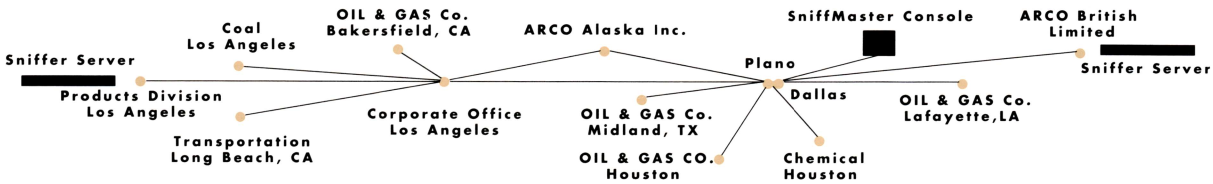
CHAIRMAN OF THE BOARD

PRESIDENT AND CHIEF EXECUTIVE OFFICER

ARCO

ARCO, the seventh largest U.S. oil and gas company, is one of the industry's most profitable producers. To achieve a competitive advantage, ARCO uses advanced technologies in everything from oil exploration and production to refining and marketing. Linking ARCO's facilities and employees around the globe is a complex web of local and wide area networks connecting nearly every conceivable type of information system.

Global Internetwork

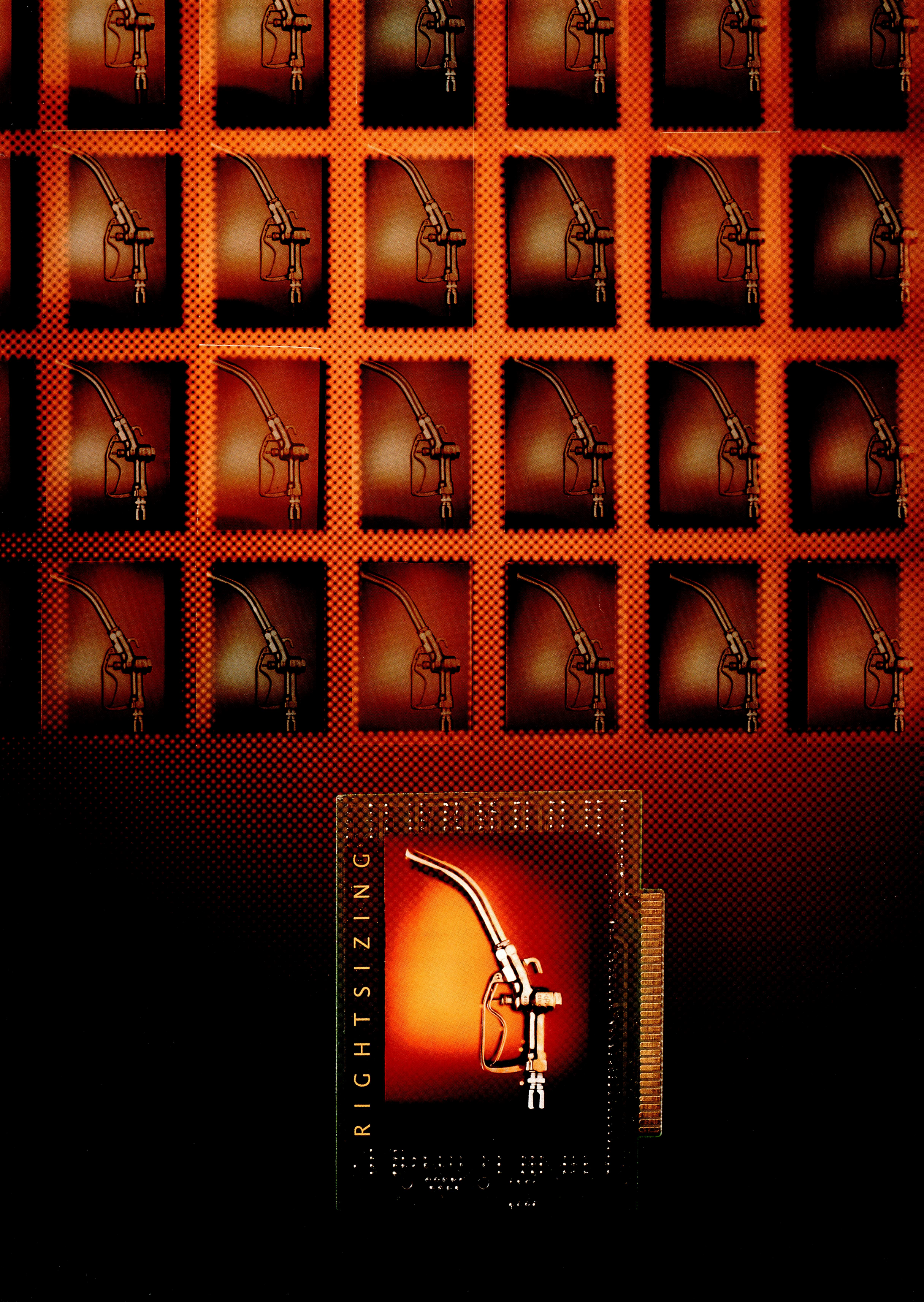


Recent restructuring and downsizing have strained ARCO's network management resources, so the challenge ahead is to manage and expand an enterprisewide network environment by better utilizing technology. To help achieve this goal, ARCO uses the Distributed Sniffer System (DSS) with Expert Analysis.

ARCO currently has 25 intelligent Sniffer Servers installed in remote network sites. With six SniffMaster Consoles distributed in different locations, ARCO's network management team can easily share information and leverage their expertise across the entire network.

Besides troubleshooting existing networks on a daily basis, ARCO's management team is constantly planning and installing new networks. The Distributed Sniffer System reveals network traffic patterns that help ARCO determine where to put new file servers, routers, and bridges. By placing a file server as close as possible to the work group that uses it, ARCO increases the efficiency of its network without increasing costs.

To leverage their investment in the Distributed Sniffer System, ARCO's network management team recently had a week of on-site training taught by Network General instructors. Erik Oistad, Director of Telecommunications at ARCO, oversees the network management team that uses DSS and he is confident that the training quickly paid for itself in increased productivity: "The Distributed Sniffer System helps our network managers find and solve problems faster and more productively. And with fewer fires to put out, my team can focus on the bigger issues of increasing network efficiency and productivity for end users."


RIGHTSIZING

CISCO SYSTEMS

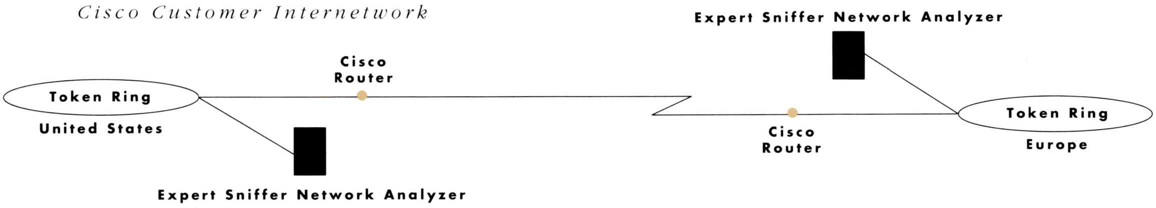
Founded in 1986, Cisco Systems, the leading manufacturer of internetworking equipment, is one of America's fastest growing companies. Much of Cisco's success comes from developing advanced technologies that continually "raise the bar" for internetworking products, and the Sniffer Network Analyzer has played a role in Cisco's success from the very start.

Cisco's engineering staff has used the Sniffer analyzer in nearly every step of their product development cycle since 1986. Today, software engineers in Cisco's labs are developing the next generation of internetworking products. And since Cisco's mission is to provide internetworking solutions for virtually any type of technology, the Sniffer analyzer's wide range of capabilities makes it an ideal development tool.

Cisco has nearly 100 Sniffer analyzers distributed around the globe for use in both pre- and post-sales support. Every day Cisco's sales engineers attach Sniffer analyzers to customer networks to provide technical sales support. Using information gathered by Sniffer analyzers, Cisco's sales force can help their customers design and implement their internetwork environments. In continuing post-sales support, Cisco system engineers use the Sniffer analyzer as a standard tool for network diagnostics and performance analysis.

Cisco's routers are at the heart of internetworks so they must guarantee their service. Because the Sniffer analyzer is accepted worldwide as the de facto standard in protocol analysis, Cisco gains instant credibility with customers when using a Sniffer analyzer to solve a problem.

Cisco Customer Internetwork



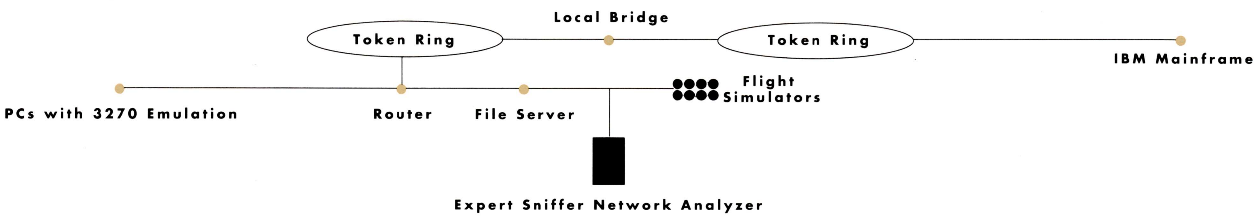
Recently, a Cisco customer was experiencing trouble with an internetwork linking local area networks between Europe and the United States. To demonstrate that Cisco routers were not at fault, Cisco's engineers placed a Sniffer analyzer at each end of the transatlantic connection. The Sniffer analyzer quickly isolated the problem to a faulty network card, proving that the packets were reaching the local networks and that Cisco's routers were doing their job.


RELIABILITY

swissair

Learning how to fly a new type of airplane safely can be a matter of life or death. Swissair, ranked as one of the world's safest and most efficient airlines, uses a $20 million flight simulator to train its pilots to fly the new Airbus 310. With eight flight simulators on-line, managing the computer network that connects these simulators is an extremely crucial job.

Flight Simulator Network

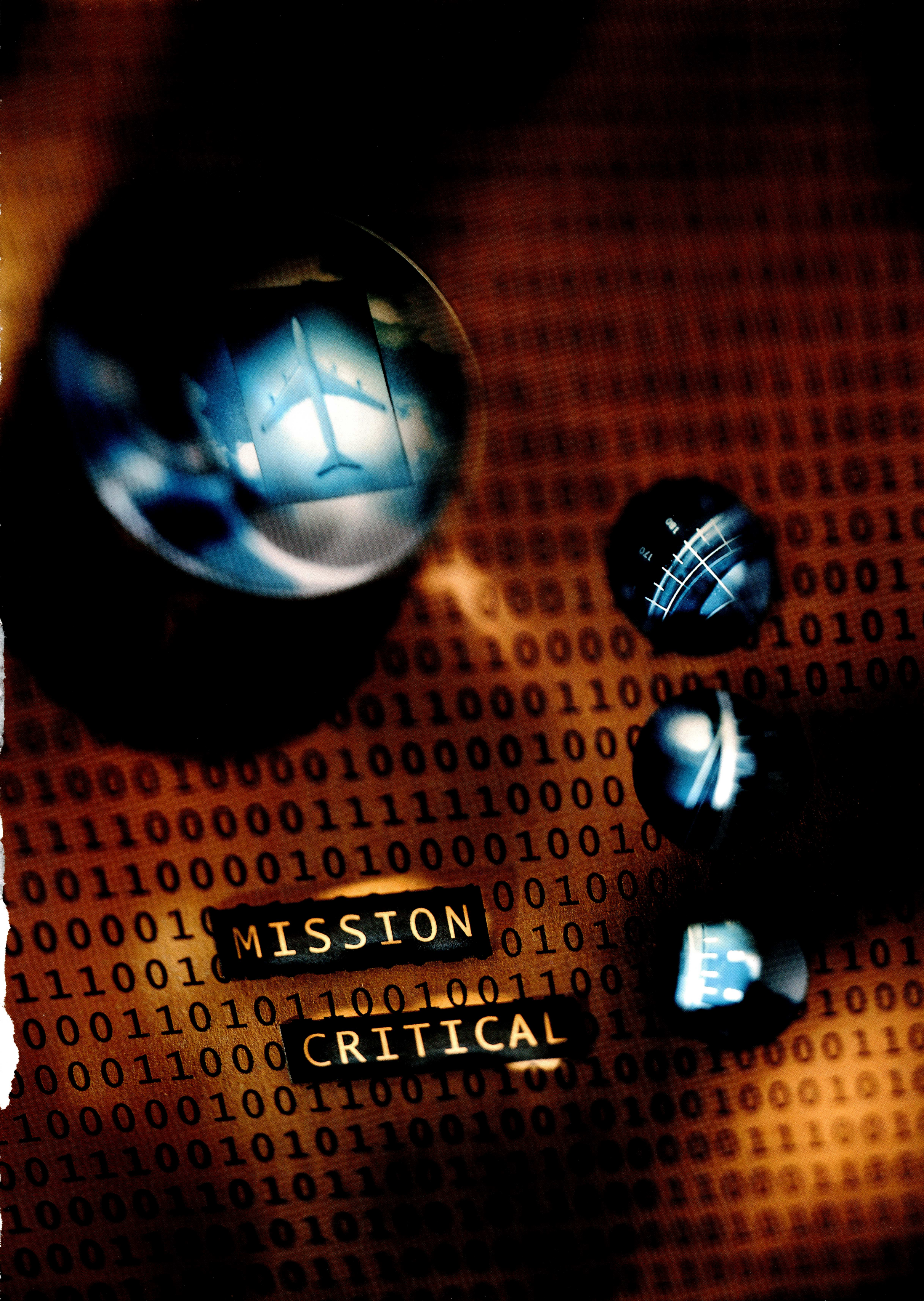


Rolf Leutert, Swissair's Manager of LAN Planning, and his team are responsible for design, installation, and support of nearly 700 local area networks in Europe. "Currently, we are using Expert Sniffer Network Analyzers to install and manage the network that supports the flight simulators," says Leutert. "It's a mission-critical application, so we use the Sniffer analyzers to help maximize network performance."

Approximately 20 programmers must have real-time access to the flight simulators to modify and support the software. Additionally, to help recoup their investment in the flight simulators, Swissair uses them 24 hours a day by leasing training time to other airlines. Sophisticated accounting software accurately tracks time on the simulators and then invoices the other airlines.

Swissair's LAN planners have designed a complex network that combines Ethernet and token ring technologies and connects PC, UNIX and mainframe devices. Swissair can't afford any downtime on this network, so before bringing a simulator on-line the Sniffer analyzer tests the network. Using the Sniffer analyzer's complete seven-layer analysis, Swissair's network managers can examine the critical applications for potential problems.

With the flight simulator installed, the Sniffer analyzer's traffic generator creates a simulated network environment while the analyzer's advanced monitoring system examines the network for inefficiencies. Finally, Swissair uses the Sniffer's Expert Analysis capabilities to troubleshoot and manage the network proactively once it's up and running.


MISSION
CRITICAL

Kidder,Peabody

In the highly competitive world of financial services, success is often determined by the ability to transact orders quickly and accurately. Financial markets can change in seconds, so even the smallest delay can lead to substantial losses both in real dollars and customer confidence.

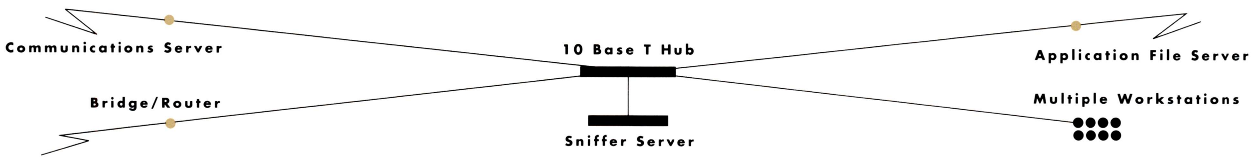
Kidder, Peabody, one of the nation's leading investment banking and retail brokerage firms, is known for providing superior, value-added service to its customers. With over 50 branch offices throughout the U.S., Kidder relies on a sophisticated computer network to process customer transactions smoothly and efficiently.

Kidder's investment executives trade securities in real time using nearly 4,000 computer workstations connected to over 100 geographically dispersed internetworks. A centralized data center monitors the system and receives information from branch offices, while orders are executed through the firm's New York trading office. To achieve maximum uptime and efficiency, Kidder uses the Distributed Sniffer System (DSS) with Expert Analysis to help monitor and manage its network operations.

With network managers in two principal locations, Kidder uses the Distributed Sniffer System to facilitate cooperative network management. SniffMaster Consoles in the data center receive alarms from Sniffer Servers running 24-hour network monitoring on network segments. If the problem cannot be solved quickly, managers with expertise in the particular problem use a SniffMaster console to remotely investigate the network segment and perform deeper analysis.

One of the key benefits of using DSS is the ability to analyze detailed network packet information which helps solve complex communications problems. Problems are quickly isolated and network operations are fully restored without affecting Kidder's ability to trade in a real time environment.

Branch Office Network



Using the Distributed Sniffer System, Kidder saves money by finding and solving network problems faster and more proactively. They have also substantially increased network responsiveness for investment executives by using DSS to fine-tune network performance and bandwidth utilization. A faster network, quicker trades, and more satisfied customers—this is the winning combination for Kidder, Peabody and Network General.

STATEMENT OF POSITION 91-1

In December 1991, the American Institute of Certified Public Accountants issued Statement of Position ("SOP") 91-1, "Software Revenue Recognition." The new SOP requires, among other things, that the sales value of customer support which is included as part of an initial warranty period must be deferred and amortized over the warranty period. This is the only provision of the SOP that impacted the Company's previously reported earnings. The Company implemented the new accounting rule in the first quarter of fiscal 1993. All financial information for the three years ended March 31, 1993, 1992 and 1991 has been restated in order to comply with SOP 91-1. Further details of the impact of SOP 91-1 is contained within the "Notes to Consolidated Financial Statements."

INCOME STATEMENT HIGHLIGHTS

	1993	%Change	1992	%Change	1991
Revenues	**$83,294**	32%	$63,145	32%	$47,831
Gross Profit	**63,471**	27%	49,968	34%	37,322
Percentage of revenues	**76%**		79%		78%
Operating Expenses	**51,555**	34%	38,425	38%	27,905
Percentage of revenues	**62%**		61%		58%
Net Income	**10,285**	21%	8,485	28%	6,652
Earnings per share	**$ .55**	4%	$ .53	23%	$ .43

REVENUES

Revenues for the fiscal year ended March 31, 1993 were $83,294,000, an increase of 32% over the $63,145,000 in revenues for the fiscal year ended March 31, 1992. Fiscal 1992 revenues of $63,145,000 were an increase of 32% over the $47,831,000 in revenues for the fiscal year ended March 31, 1991. Both domestic and international revenues increased for fiscal 1993 when compared to fiscal 1992, and for fiscal 1992 when compared to fiscal 1991. International revenues increased by 31% for the year ended March 31, 1993 compared to the year ended March 31, 1992, growing from $15,533,000 to $20,313,000. International revenues increased by 46% for the year ended March 31, 1992 compared to the year ended March 31, 1991, growing from $10,614,000 to $15,533,000. International revenues represented 24% of revenues for the year ended March 31, 1993, compared to 25% for the year ended March 31, 1992 and 22% for the year ended March 31, 1991.

The following table presents the Company's revenues for each of its product lines in absolute dollars and as a percentage of revenues for each of the periods shown below.

Sources of Revenues	**Fiscal 1993**	%Change	Fiscal 1992	%Change	Fiscal 1991
Tool Products[1]	**$53,091**	20%	$44,167	1%	$43,583
System Products[2]	**17,308**	46%	11,866	—	—
Subtotal Product Revenues	**70,399**	26%	56,033	29%	43,583
Services[3]	**12,895**	81%	7,112	68%	4,248
Total Revenues	**$83,294**	32%	$63,145	32%	$47,831

Percentage of Revenues	**Fiscal 1993**	Fiscal 1992	Fiscal 1991
Tool Products[1]	**64%**	70%	91%
System Products[2]	**21%**	19%	—
Subtotal Product Revenues	**85%**	89%	91%
Services[3]	**15%**	11%	9%
Total Revenues	**100%**	100%	100%

[1] Tool Products include revenues from the Sniffer Network Analyzer products, the PCI line of Wide Area Network (WAN) Analysis products, the Watchdog Network Monitor products, product rentals, and royalties from license agreements. Prior to the second quarter of fiscal 1993, the PCI line of Wide Area Network (WAN) Analysis products, the Watchdog Network Monitor products, product rentals, and royalties from license agreements were categorized separately as "Other Products."

[2] System Products consist solely of revenues from the Distributed Sniffer System product line.

[3] Service revenues include first-year warranty revenue as defined by SOP 91-1 and revenues from software support and maintenance contracts, training, and consulting services.

The Company's Tool Product revenues increased in the year ended March 31, 1993 to $53,091,000, a 20% increase over the $44,167,000 in Tool Product revenues for the year ended March 31, 1992. Fiscal 1992 Tool Product revenues increased 1% over the $43,583,000 in Tool Product revenues for the year ended March 31, 1991. Increased sales of the Company's Sniffer Network Analyzer products were responsible for almost all of the increase in Tool Product revenues between fiscal 1992 and fiscal 1993. International sales of Sniffer Network Analyzer products grew faster than domestic sales of Sniffer Network Analyzer products during both fiscal 1993 and fiscal 1992. As a percent of total revenues, Tool Product revenues were 91% of total revenues in fiscal 1991, compared to 70% of total revenues in fiscal 1992 and 64% of total revenues in fiscal 1993. Tool Product revenues declined as a percentage of total revenues due to growth in both System Product revenues and Service revenues during these time periods.

Revenues for fiscal 1993 included $17,308,000 in System Products revenues, a 46% increase as compared to the $11,866,000 in System Products revenues in fiscal 1992. Distributed Sniffer System (DSS) products accounted for all of the Company's System Products revenues in each of fiscal 1993 and fiscal 1992. The Company began shipping DSS products in June 1991. System Products revenues represented approximately 21% of Network General's total revenues for the year ended March 31, 1993, as compared to 19% of Network General's total revenues for the year ended March 31, 1992.

Service revenues are comprised of revenues from training, software support and maintenance contracts, and consulting services. Also included in Service revenues are those revenues from the first year warranty period of customer support as defined by SOP 91-1. For the year ended March 31, 1993, Service revenues totaled $12,895,000, an increase of 81% from the $7,112,000 in Service revenues for the year ended March 31, 1992. For the year ended March 31, 1992, Service revenues totaled $7,112,000, an increase of 68% from the $4,248,000 in Service revenues for the year ended March 31, 1991. The increase in Service revenues during both periods was due to increases in all categories of Service revenues. As a percentage of total revenues, Service revenues were 15% of total revenues in fiscal 1993, 11% of total revenues in fiscal 1992 and 9% of total revenues in fiscal 1991.

Gross Profit

(As a Percentage of Related Revenues)	**1993**	1992	1991
Products	**75%**	78%	77%
Services	**80%**	85%	89%
Total	**76%**	79%	78%

Costs of revenues consist of manufacturing costs, cost of services and warranty expenses. Gross profit as a percent of revenue was 76%, 79% and 78% for the years ended March 31, 1993, 1992 and 1991, respectively. The reduction in gross profit percentage in fiscal 1993 as compared to fiscal 1992 was primarily due to increased platform sales within the Tools Products line. Platform sales have very little or no gross margin relative to the other products in the Tools Products line, and the higher the portion of sales of platforms in the

Tools Products line mix, the greater the negative impact on percentage gross margin. During the second half of fiscal 1993, the limited availability of Compaq 486 color portable computers through normal sales channels led the Company to purchase and resell to its customers a significant number of such platforms. These platforms are used with the Company's model 55 and 57 Sniffer Network Analyzer products, which accounted for a majority of the Company's Tools Product revenues in fiscal 1993.

The Company believes the limited availability of the Compaq 486 color portable computer will continue at least through the quarter ending June 30, 1993.

Sales and Marketing Expenses

	1993	%Change	1992	%Change	1991
Sales and Marketing Expenses	**$35,261**	34%	$26,252	30%	$20,156
Percentage of Revenues	**42%**		42%		42%

Sales and marketing expenses were $35,261,000 in fiscal 1993, an increase of 34% compared to $26,252,000 in fiscal 1992. Fiscal 1992 sales and marketing expenses increased 30% compared to the $20,156,000 of such expenses in fiscal 1991. The primary reason for the increase in sales and marketing expenses for both fiscal 1993 as compared to fiscal 1992 and for fiscal 1992 as compared to fiscal 1991 was increases in domestic sales expense. As a percent of revenues, sales and marketing expenses were 42% of revenues in each of the last three fiscal years ended March 31, 1993, 1992 and 1991.

During fiscal 1993, the Company continued to expand its domestic direct sales force. In most cases, the expansion occurred through negotiated agreements with the Company's independent manufacturers' representatives which permitted the Company to hire individuals who previously represented Network General products as employees of independent manufacturers' representatives. As a result of this expansion, the Company had 158 domestic sales employees at March 31, 1993, as compared to 90 at March 31, 1992 and 54 at March 31, 1991. The expansion of the Company's domestic direct sales force has increased the fixed portion of the Company's sales and marketing expenses. Independent manufacturers' representatives are paid solely on commission which varies with revenues, while the Company's domestic direct sales personnel receive a fixed base salary and a variable commission based on revenues. Therefore, lower-than-anticipated revenues would have a greater adverse impact on operating results with an internal domestic sales force than they would have had if only manufacturers' representatives were employed.

The Company incurred approximately $1,355,000 and $425,000 in sales and marketing expenses for the years ended March 31, 1993 and March 31, 1992, respectively, relating to the amortization of the cost of terminating sales arrangements with its domestic manufacturers' representatives. The Company expects to incur approximately $400,000 in expenses due to the amortization of previously executed buyouts during fiscal 1994.

Research and Development Expenses

	1993	%Change	1992	%Change	1991
Research and Development Expenses	**$11,106**	72%	$6,474	59%	$4,079
Percentage of Revenues	**13%**		10%		9%

Research and development expenses were $11,106,000 in fiscal 1993, as compared to $6,474,000 in fiscal 1992 and $4,079,000 in fiscal 1991. Research and development expenses as a percent of revenues were 13%, 10% and 9% for the years ended March 31, 1993, 1992 and 1991, respectively. The increase in research and development expenses in both fiscal 1993 when compared to fiscal 1992 and fiscal 1992 when compared to fiscal 1991 was due to increased staffing to support development efforts. These efforts produced products such as the Sniffer Internetwork Analyzer and Expert DSS. The Company believes that continued commitment to research and development is required to remain competitive.

Research and development expenses are accounted for in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, under which the Company is required to capitalize software development costs after technological feasibility is established. Capitalizable software development costs incurred to date have not been significant and, thus, the Company has charged all software development costs to research and development expenses in the consolidated statements of income.

General and Administrative Expenses

	1993	%Change	1992	%Change	1991
General and Administrative					
Expenses	**$5,188**	18%	$4,383	(1%)	$4,434
Percentage of Revenues	**6%**		7%		9%

General and administrative expenses for the fiscal year ended March 31, 1993 were $5,188,000, as compared to $4,383,000 for the fiscal year ended March 31, 1992 and $4,434,000 for the fiscal year ended March 31, 1991. General and administrative expenses as a percent of revenues were 6%, 7% and 9% for the fiscal years ended March 31, 1993, 1992 and 1991, respectively. The increase in general and administrative expenses in fiscal 1993 when compared to fiscal 1992 was primarily due to increased staffing, and to a lesser extent, increased use of outside services to support the growth of the Company. General and administrative expenses decreased slightly in fiscal 1992 as compared to fiscal 1991 due to savings achieved through reductions in staff following the acquisition of Progressive Computing, Inc.

Other Operating Expenses

There were no Other Operating Expenses in fiscal 1993. Other Operating Expenses of $1,316,000 were reported in fiscal 1992, as a result of the acquisition of Progressive Computing, Inc., and the termination of a sales agreement with Quad Technologies. This is compared to a gain on the sale of a product line in fiscal 1991, which resulted in $764,000 of operating income.

Interest Income

	1993	%Change	1992	%Change	1991
Interest Income	**$3,322**	120%	$1,507	(4%)	$1,567
Percentage of Revenues	**4%**		2%		3%

Interest income increased to $3,322,000 in fiscal 1993 as compared to $1,507,000 in fiscal 1992, which had decreased as compared to the $1,567,000 of interest income earned in fiscal 1991. The increase in interest income in fiscal 1993 as compared to fiscal 1992 was primarily due to a higher amount of cash, cash equivalents and marketable securities available for investment in fiscal 1993, including approximately $46,000,000 raised by the Company in a public offering of common stock completed in April 1992. Although interest income increased in fiscal 1993 as compared to fiscal 1992, interest rates in general were lower in fiscal 1993. The decrease in fiscal 1992 as compared to fiscal 1991 was primarily due to lower interest income received from investments, reflecting the decline in interest rates between fiscal 1991 and fiscal 1992.

Provision for Income Taxes

	1993	%Change	1992	%Change	1991
Provision for Income Tax	**$4,953**	8%	$4,565	30%	$3,510
Effective Tax Rate	**32.5%**		35%		32%

The provision for income taxes was 32.5% of pretax income for the year ended March 31, 1993, as compared to 35% for the year ended March 31, 1992 and 32% for the year ended March 31, 1991. The decrease in the effective tax rate in fiscal 1993 as compared to fiscal 1992 reflects the benefits derived from the Company's Foreign Sales Corporation, research and development tax credits, investment in tax-exempt instruments, and the one-time impact of the acquisition of PCI in fiscal 1992. The increase in the effective tax rate for fiscal 1992 as compared to fiscal 1991 reflects the tax effect of the expenses associated with the acquisition of Progressive Computing, Inc. in the second quarter of fiscal 1992, since a portion of those expenses were not tax-deductible.

In February 1992, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." The Company has adopted the provisions of this Statement on a prospective basis in the first quarter of fiscal 1993 and the effect on its financial statements, upon adoption, was not significant.

Earnings per Share

Earnings per share for the year ended March 31, 1993 were $0.55, an increase in earnings per share of 4% compared to the $0.53 per share earned in the year ended March 31, 1992. Fiscal 1992 earnings per share increased 23% compared to the $0.43 per share earned in the year ended March 31, 1991. The number of common share equivalents used to calculate earnings per share increased by 18% between March 31, 1992 and March 31, 1993 primarily due to the Company's public offering in April 1992. Earnings in fiscal 1991 included income of approximately $0.03 per share relating to the sale of a product line of Progressive Computing, Inc. Earnings were reduced in fiscal 1991 by approximately $0.06 per share due to the cumulative effect from prior fiscal years of adopting Statement of Position 91-1. Earnings were reduced in fiscal 1992 by approximately $0.07 per share primarily due to costs associated with the acquisition of Progressive Computing, Inc. and, to a lesser extent, the termination of a sales agreement with Quad Technologies.

Liquidity and Capital Resources

	1993	%Change	1992	%Change	1991
Cash, cash equivalents, and marketable securities	**$30,222**	(15%)	$35,422	18%	$30,107
Working capital	**41,773**	(9%)	45,946	26%	36,561
Net cash provided by operating activities	**12,732**	73%	7,347	47%	4,995
Net cash used in investing activities	**61,745**	224%	19,057	85%	10,304
Net cash provided by financing activities	**48,695**	1842%	2,507	411%	491

Net cash provided by operating activities was $12,732,000 for the fiscal year ended March 31, 1993, as compared to $7,347,000 for the fiscal year ended March 31, 1992 and $4,995,000 for the fiscal year ended March 31, 1991. The net increase in fiscal 1993 when compared to both fiscal 1992 and to fiscal 1991 is primarily due to increases in net income, deferred revenue, accounts payable and accrued liabilities. This increase was partially offset by an increase in accounts receivable and in inventories. Net accounts receivable as of March 31, 1993 were $18,281,000, an increase of $4,037,000 from the net accounts receivable of $14,244,000 as of March 31, 1992. The increase in net accounts receivable is primarily due to the increase in fourth quarter revenues from $18,702,000 in the fourth quarter of fiscal 1992 to $23,597,000 in the fourth quarter of fiscal 1993.

The Company had a net decrease in cash, cash equivalents and marketable securities of $5,200,000 between March 31, 1992 and March 31, 1993, as compared to a net increase in cash, cash equivalents and marketable securities of $5,315,000 between March 31, 1991 and March 31, 1992. The decrease in fiscal 1993 was primarily due to the reinvestment of funds from investments classified as cash equivalents and marketable securities into long-term investments. The increase in fiscal 1992 was due to investment of cash provided by operating activities into marketable securities. The Company used $61,745,000 in cash to participate in investing activities during fiscal 1993 primarily related to investing excess cash in long-term investments and to a lesser extent the purchase of property and equipment. The primary source of those funds was approximately $46,000,000 raised by the Company's public offering of stock in April 1992 and net income from operations. In fiscal 1992 the Company used $19,057,000 in cash for investing activities, of which $14,518,000 was due to the transfer to investments classified as marketable securities from those classified as cash equivalents. In fiscal 1991 the Company used $10,304,000 in cash for investing activities, of which $8,200,000 was due to the transfer to investments classified as marketable securities from those classified as cash equivalents. The $46,000,000 in proceeds from the April 1992 public offering of the Company's stock produced most of the $48,695,000 in cash that was provided by financing activities in fiscal 1993. In fiscal 1992 and fiscal 1991 cash provided by financing activities was primarily due to the exercise of employee stock options generating $2,507,000 in fiscal 1992 and $628,000 in fiscal 1991.

As of March 31, 1993, the Company's principal sources of liquidity included cash, cash investments and marketable securities of approximately $30,222,000, as compared to $35,422,000 as of March 31, 1992. In addition, the Company has invested $59,713,000 in long-term investments as of March 31, 1993. The principal sources of these funds, investments and securities were the Company's three public offerings of common stock and from operations. The Company currently has no outstanding bank borrowings and has no established lines of credit. The Company believes that current cash and marketable securities, together with existing sources of liquidity and anticipated funds from operations, will satisfy the Company's normal projected working capital and capital expenditure requirements for at least the next twelve months.

The Company has generated positive cash flow from operations over the past three fiscal years. During this period the Company has funded acquisitions through a combination of stock and cash. The amounts of cash used have not been significant relative to the Company's sources of short-term liquidity. The Company expects that any acquisitions in the future would be made through the same methods of funding.

Business Risks

Certain characteristics and dynamics of Network General's markets, technologies and operations create risks to the Company's long-term success and to predictable quarterly results. These dynamics include:

1) The market for Network General's products is characterized by rapidly changing technology and evolving industry standards. Network General believes that its future success will depend in part on its ability to continue to develop and introduce new products. The Company is committed to continued investments in research and development; however, there is no assurance that these efforts will result in the development of new products or if products are developed, that they will achieve market acceptance. In addition, the inability to release new products on announced release dates could result in delays in orders and product shipments, which would have a material adverse effect on quarterly results.

2) Network General typically operates with very little backlog and most of its revenues in each quarter result from orders booked in that quarter. Further, Network General typically generates approximately one-half of its revenues for each quarter in the last month of the quarter. The Company establishes its expenditure levels based on its expectations as to future revenues, and if revenue levels are below expectations, this could cause expenditures to be disproportionately high. Therefore, a drop in near-term demand would significantly affect revenues, causing a disproportionate reduction in profits in any quarter.

3) Network General relies on a single supplier or limited number of suppliers for certain critical components of its products. Each Network General product series is designed around a specific computer platform available only from a single manufacturer. In the case of the Company's Sniffer Network Analyzer products, customers purchase the required platform either from the Company or from third party suppliers. However, from time to time the Company and its customers have experienced difficulties in obtaining required platforms. Such a gap in supply can result from several factors, including instances where a manufacturer announces the phasing out of one product model and the phasing in of a new one. When such a shortage occurs, the Company's practice has been to attempt to purchase platforms for resale to its customers at little or no mark-up. Such resales have increased revenues, but have also adversely affected percentage gross margin. Any significant shortage of adequate platforms or other sole source or limited source components for the Company's products could lead to cancellations or delays of purchases of the Company's products, which would materially and adversely affect the Company's results of operations. In addition, an announcement by a platform supplier of an impending release of a new platform could lead to such delays and cancellations, which would also adversely affect results of operations.

Consolidated Statements of Income Data[1]

(In thousands, except per share amounts)	Year ended March 31, 1993	1992	1991	1990	1989
Revenues	**$83,294**	$63,145	$47,831	$31,593	$14,249
Income from operations	**11,916**	11,543	9,417	8,137	4,145
Income before cumulative effect of change in accounting method	**10,285**	8,485	7,474	5,855	2,696
Net income	**10,285**	8,485	6,652	5,855	2,696
Earnings per share before cumulative effect of change in accounting method	**$ .55**	$ .53	$ .49	$ .41	$ .25
Earnings per share	**$ .55**	$ .53	$ .43	$ .41	$ .25
Weighted average common and common equivalent shares outstanding	**18,767**	15,926	15,325	14,409	10,708

Consolidated Balance Sheet Data[1]

(Dollars in thousands)	As of March 31, 1993	1992	1991	1990	1989
Working capital	**$ 41,773**	$45,946	$36,561	$30,403	$14,629
Total assets	**130,132**	66,175	47,819	37,287	17,360
Long-term obligations	**1,524**	1,026	222	232	247
Total stockholders equity	**$110,069**	$51,662	$40,670	$33,217	$15,233

Quarterly Financial Data[1] (unaudited)

(In thousands, except per share and stock price amounts)

	Mar. 31, '93	Dec. 31, '92	Sept. 30, '92	June 30, '92	Mar. 31, '92	Dec. 31, '91	Sept. 30, '91	June 30, '91
Revenues	**$23,597**	$24,058	$20,156	$15,483	$18,702	$17,116	$14,368	$12,959
Gross profit	**17,987**	18,054	15,360	12,070	14,932	13,706	11,147	10,183
Income from operations	**3,161**	4,392	3,376	987	4,172	3,823	1,436	2,112
Income before provision for income taxes	**4,159**	5,272	4,139	1,668	4,510	4,200	1,840	2,500
Net income	**2,807**	3,559	2,794	1,125	3,004	2,815	967	1,699
Earnings per share	**$ 0.15**	$ 0.19	$ 0.15	$ 0.06	$ 0.18	$ 0.18	$ 0.06	$ 0.11
Price range common stock	**$ 20.13- $ 10.00**	$ 19.25- $ 9.75	$ 19.50- $ 8.00	$ 23.25- $ 15.50	$ 25.50- $ 15.63	$ 17.25- $ 12.00	$ 14.38- $ 6.75	$ 9.75- $ 7.00

[1]Amounts for fiscal 1993, fiscal 1992 and fiscal 1991 including the quarterly financial data presented have been restated in order to comply with Statement of Position 91-1. Fiscal 1990 and fiscal 1989 have not been restated. The cumulative effect of the change in accounting method for the years prior to fiscal 1991 was an $822,000 reduction to net income. This is reflected in fiscal 1991.

(Dollars in thousands, except per share amounts)	As of March 31, 1993	1992
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,386	$ 7,704
Marketable securities	22,836	27,718
Accounts receivable, net of allowance for doubtful accounts of $621 in 1993 and $445 in 1992	18,281	14,244
Inventories	4,921	4,005
Prepaid expenses and deposits	6,888	5,762
Total current assets	60,312	59,433
Property and Equipment at cost:		
Demonstration and rental equipment	5,055	3,583
Office and development equipment	11,265	7,059
Leasehold improvements	1,163	500
	17,483	11,142
Less—accumulated depreciation and amortization	(7,970)	(5,185)
Net property and equipment	9,513	5,957
Long-term Investments	59,713	—
Other Assets	594	785
	$130,132	$66,175
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 4,089	$ 3,465
Accrued liabilities	7,330	4,701
Deferred revenue	7,120	5,321
Total current liabilities	18,539	13,487
Long-term Obligations	1,524	1,026
Stockholders' Equity:		
Preferred stock—$.01 par value Authorized—2,000,000 shares Outstanding—none	—	—
Common stock—$.01 par value Authorized—50,000,000 shares Outstanding—18,421,826 shares in 1993 and 15,615,608 shares in 1992	184	156
Additional paid-in capital	75,135	27,041
Retained earnings	34,750	24,465
Total stockholders' equity	110,069	51,662
	$130,132	$66,175

The accompanying notes are an integral part of these consolidated financial statements.

(In thousands, except per share amounts)	1993	1992	1991
	For the three years ended March 31,		
Revenues:			
Product Revenues	**$70,399**	$56,033	$43,583
Service Revenues	**12,895**	7,112	4,248
Total Revenues	**83,294**	63,145	47,831
Cost of Revenues:			
Product	**17,297**	12,114	10,025
Service	**2,526**	1,063	484
Total Cost of Revenues	**19,823**	13,177	10,509
Gross Profit	**63,471**	49,968	37,322
Operating Expenses:			
Sales and marketing	**35,261**	26,252	20,156
Research and development	**11,106**	6,474	4,079
General and administrative	**5,188**	4,383	4,434
Gain on sale of product line	**—**	—	(764)
Other operating expenses	**—**	1,316	—
Total Operating Expenses	**51,555**	38,425	27,905
Income from Operations	**11,916**	11,543	9,417
Interest Income, net	**3,322**	1,507	1,567
Income before provision for income taxes and cumulative effect of change in accounting method	**15,238**	13,050	10,984
Provision for Income Taxes	**4,953**	4,565	3,510
Income before cumulative effect of change in accounting method	**10,285**	8,485	7,474
Cumulative Effect of Change in Accounting Method, Net of Related Income Tax Effects (See Note 2)	**—**	—	(822)
Net Income	**$10,285**	$ 8,485	$ 6,652
Earnings Per Share:			
Earnings per share before cumulative effect of change in accounting method	**$ .55**	$ .53	$ .49
Cumulative effect of change in accounting method	**—**	—	(.06)
Earnings Per Share	**$ .55**	$ .53	$ .43
Weighted Average Common and Common Equivalent Shares Outstanding	**18,767**	15,926	15,325

The accompanying notes are an integral part of these consolidated financial statements.

For the three years ended March 31,
(Dollars in thousands, except per share amounts)

	Common Stock		Additional Paid-in	Retained	
	Shares	Amount	Capital	Earnings	Total
BALANCE—MARCH 31, 1990	14,916,955	$149	$23,740	$ 9,328	$ 33,217
Issuance of common stock under the Employee Stock Purchase Plan at \$6.80 and \$9.14 per share	28,680	1	222	—	223
Exercise of stock options at \$4.00—\$6.38 per share	36,972	1	155	—	156
Conversion of notes	131,208	—	170	—	170
Repurchase of stock	(4,205)	—	(9)	—	(9)
Issuance of common stock for services rendered, net	32,051	—	261	—	261
Net income	—	—	—	6,652	6,652
BALANCE—MARCH 31, 1991	15,141,661	151	24,539	15,980	40,670
Issuance of common stock under the Employee Stock Purchase Plan at \$7.01 per share	56,980	1	398	—	399
Exercise of stock options at \$2.03—\$8.25 per share	416,967	4	2,104	—	2,108
Net income	—	—	—	8,485	8,485
BALANCE—MARCH 31, 1992	15,615,608	156	27,041	24,465	51,662
Public offering of common stock at \$19.50 per share, net of issuance costs of \$2,948	2,500,000	25	45,777	—	45,802
Issuance of common stock under the Employee Stock Purchase Plan at \$8.29—\$16.15 per share	80,542	1	804	—	805
Exercise of stock options at \$2.03—\$13.38 per share	225,676	2	1,183	—	1,185
Tax benefit of stock options	—	—	903	—	903
Lower of cost or market adjustment on long-term investments	—	—	(573)	—	(573)
Net income	—	—	—	10,285	10,285
BALANCE—MARCH 31, 1993	18,421,826	$184	$75,135	$34,750	$110,069

The accompanying notes are an integral part of these consolidated financial statements.

(In thousands)	For the three years ended March 31, 1993	1992	1991
Cash Flows from Operating Activities			
Net income	**$ 10,285**	$ 8,485	$ 6,652
Adjustments to reconcile net income to net cash provided by operating activities—			
Depreciation and amortization	**2,785**	2,397	1,856
Gain on sale of product line	**—**	—	(764)
Fair market value of stock awards	**—**	—	12
Deferred taxes	**221**	180	222
Provisions for doubtful accounts	**74**	350	390
(Increase) decrease in assets			
Accounts receivable	**(4,111)**	(6,472)	(3,116)
Inventories	**(916)**	(1,805)	(838)
Prepaid expenses and deposits	**(1,126)**	(2,703)	(2,366)
Other assets	**191**	(269)	(257)
Increase (decrease) in liabilities			
Accounts payable and accrued liabilities	**1,566**	3,616	700
Income taxes payable	**1,687**	606	(303)
Deferred revenue	**2,076**	2,962	2,807
Net cash provided by operating activities	**12,732**	7,347	4,995
Cash Flows from Investing Activities			
(Increase) decrease in marketable securities	**4,882**	(14,518)	(8,200)
(Increase) in long-term investments	**(60,286)**	—	—
Sale of rental equipment	**—**	—	89
Net proceeds from sale of product line	**—**	—	827
Purchase of product line	**—**	—	(108)
Purchase of property & equipment	**(6,341)**	(4,539)	(2,912)
Net cash used in investing activities	**(61,745)**	(19,057)	(10,304)
Cash Flows from Financing Activities			
Proceeds from issuance of common stock, net of issuance costs	**48,695**	2,507	628
Repurchase of common stock	**—**	—	(9)
Decrease in short-term and long-term notes payable	**—**	—	(128)
Net cash provided by financing activities	**48,695**	2,507	491
Net decrease in cash and cash equivalents	**(318)**	(9,203)	(4,818)
Cash and Cash Equivalents at Beginning of Period	**7,704**	16,907	21,725
Cash and Cash Equivalents at End of Period	**$ 7,386**	$ 7,704	$ 16,907

The accompanying notes are an integral part of these consolidated financial statements.

1. Operations

Network General Corporation (the "Company") designs, markets and supports software-based network management applications for a broad spectrum of physical connection technologies and communications protocols. The Company was incorporated in 1986 as a California corporation and changed its state of incorporation to Delaware in fiscal 1988.

2. Summary of Significant Accounting Policies

Consolidation. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, after elimination of intercompany accounts and transactions.

Acquisition. In August 1991, the Company acquired all of the outstanding shares of common stock of Progressive Computing, Inc. ("PCI") in exchange for approximately 900,000 shares of the Company's common stock. The Company also assumed PCI's outstanding stock options. The merger was accounted for as a pooling of interests and, accordingly, the financial statements for prior periods have been restated to include the results of PCI.

Statement of Position 91-1. In December 1991, the American Institute of Certified Public Accountants issued Statement of Position ("SOP") 91-1, "Software Revenue Recognition." The new SOP requires among other things, that the sales value of customer support which is included as part of an initial warranty period must be deferred and amortized over the warranty period. This is the only provision of the SOP that impacted the Company's previously reported earnings. The Company implemented the new accounting rule in the first quarter of fiscal 1993. All financial information for the three years ended March 31, 1993, 1992 and 1991 has been restated in order to comply with SOP 91-1.

Adoption of SOP 91-1 resulted in several changes to previously reported financial data. The table below details the impact on previously reported revenues and net income for the quarter ended March 31, 1992, and for the fiscal years ended March 31, 1992 and March 31, 1991.

	Quarter Ended March 31, 1992	Fiscal Year Ended March 31, 1992	Fiscal Year Ended March 31, 1991
Revenues:			
Previously Reported	$19,026	$63,985	$48,438
Impact of SOP 91-1	(324)	(840)	(607)
As Restated	$18,702	$63,145	$47,831
Net Income:			
Previously Reported	$ 3,203	$ 8,987	$ 7,850
Impact of SOP 91-1	(199)	(502)	(376)
Cumulative Effect of Change in Accounting Method, net of related income tax effects	—	—	(822)
As Restated	$ 3,004	$ 8,485	$ 6,652

Revenues. The Company recognizes product revenues upon shipment of the systems or software. Revenues on rental units under operating leases and service agreements are recognized ratably over the term of the rental or service period. Revenues for training courses are recognized once the course has been completed by the customer. Payments received in advance under such contracts are recorded as deferred revenues. Royalty income is recognized based on the number of copies of software sold by the licensees of the software products. No single customer accounted for more than 10% of revenues in fiscal 1993, 1992, or 1991. Export revenues as a percentage of revenues consist of:

	1993	1992	1991
Europe	14%	15%	14%
Asia/Americas	10%	10%	8%
Total Export Revenues	24%	25%	22%

Cash and Cash Equivalents. For purposes of the consolidated statements of cash flows, the Company considers certificates of deposits, commercial paper and money market funds with an original maturity date of three months or less to be cash equivalents.

Marketable Securities. Marketable securities have average maturities of less than one year, and are carried at the lower of cost or market. As of March 31, marketable securities consist of (in thousands):

	1993	1992
Municipal notes and floaters	$22,836	$20,218
Money market preferred stock	—	7,500
	$22,836	$27,718

Long-Term Investments. Long-term investments have maturities greater than one year. Equity securities are carried at the lower of cost or market, and the valuation adjustment of $573,000 as of March 31, 1993 is included as a component of stockholders' equity. Debt securities are carried at cost net of unamortized premiums or discounts. The Company began investing in long-term investments during fiscal 1993, and intends to hold these investments until maturity. As of March 31, long-term investments consist of (in thousands):

	1993
Municipal bonds	$50,017
Multi-market mutual fund	9,696
	$59,713

Inventories. Inventories are stated at the lower of cost (first-in, first-out) or market and include material, labor and related manufacturing overhead. As of March 31, inventories consist of (in thousands):

	1993	1992
Purchased parts	$2,336	$2,634
Finished goods	2,585	1,371
	$4,921	$4,005

Property and Equipment. Property and equipment are depreciated and/or amortized using the straight-line method over the following estimated useful lives:

	Life
Demonstration and rental equipment	2 years
Office and development equipment	3 to 5 years
Leasehold improvements	Lease Term

Software Development Costs. The Company anticipates capitalizing eligible computer software development costs upon the establishment of technological feasibility, which the Company has defined as completion of a working model. As of March 31, 1993, costs which were eligible for capitalization were insignificant and, thus, the Company has charged all software development costs to research and development expense in the accompanying consolidated statements of income.

Earnings Per Share. Earnings per share is computed using the weighted average number of shares of common and common equivalent shares resulting from outstanding options. Fully diluted earnings per share is the same as primary earnings per share.

3. Concentrations of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of both short- and long-term marketable security investments and trade receivables. The Company has cash investment policies that limit the amount of credit exposure to any one issuer and restrict placement of these investments to issuers evaluated as creditworthy. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising the Company's customer base and their dispersion across many different industries and geographies.

4. Accrued Liabilities

As of March 31, accrued liabilities consist of the following (in thousands):

	1993	1992
Accrued compensation and related taxes	**$2,029**	$1,899
Accrued commissions	**1,391**	1,614
Accrued income taxes	**1,998**	329
Accrued sales and use taxes	**340**	300
Other accrued expenses	**1,572**	559
	$7,330	$4,701

5. Commitments

The Company leases its facilities and certain equipment under noncancelable operating lease agreements. As of March 31, 1993, the minimum future lease payments under these leases are as follows (in thousands):

Fiscal Year	
1994	$3,006
1995	2,958
1996	1,796
1997	1,524
1998	343
	$9,627

Total rent expenses were approximately $2,329,000, $983,000 and $859,000 in fiscal 1993, 1992 and 1991, respectively.

6. Employee Savings Plan

In September 1988, the Board of Directors approved an employee savings plan (the "Plan") which is intended to be qualified and exempt from tax under section 401(k) of the Internal Revenue Code. Under the Plan, employees may elect to contribute up to 15% of their gross compensation. The Company contributes to the Plan in amounts determined at the discretion of the Board of Directors. All contributions by the Company are funded currently and vest ratably over three years. All employee contributions are fully vested. Amounts provided by the Company under the Plan to date have not been material.

7. Common Stock

In August 1990, the Company completed a two-for-one stock split effected in the form of a stock dividend. All share and per share data have been adjusted to reflect the stock split. The Company completed a third public offering of its common stock in April 1992 at $19.50 per share. Proceeds to the Company were approximately $46,000,000 and are being used for general corporate purposes.

Employee Stock Option Plan. Under the Company's 1989 Employee Stock Option Plan, key employees, employee directors and consultants may be granted either incentive or non-qualified options to purchase common stock at the discretion of the Board of Directors. The Company currently has authorized a total of 3,500,000 shares for issuance under this plan. The exercise price of the stock options may not be less than the fair market value of the common stock on the date of the grant for incentive options or less than 85% of the fair market value of the common stock on the date of the grant for non-qualified options. Generally, all options either vest ratably over a three year period or in a lump sum amount at the end of three years.

Option activity under the 1989 Employee Stock Option Plan is summarized as follows:

	Available for Grant	Outstanding	Price Per Share
Balance as of March 31, 1990	923,200	573,130	$4.00 -$12.24
Authorization Increase	500,000	—	—
Granted	(1,174,510)	1,174,510	$4.00 -$11.75
Cancelled	428,764	(428,764)	$4.00 -$12.24
Exercised	—	(36,972)	$4.00 -$ 6.38
Balance as of March 31, 1991	677,454	1,281,904	$4.00 -$12.24
Authorization Increase	1,500,000	—	—
Granted	(1,101,998)	1,101,998	$7.50 -$22.75
Cancelled	218,824	(218,824)	$4.00 -$14.50
Exercised	—	(273,802)	$4.00 -$ 8.25
Balance as of March 31, 1992	1,294,280	1,891,276	$4.00 -$22.75
Granted	(1,735,543)	1,735,543	$8.75 -$19.00
Cancelled	625,341	(625,341)	$4.375-$22.75
Exercised	—	(185,364)	$4.00 -$13.375
Balance as of March 31, 1993	184,078	2,816,114	$4.00 -$19.00

Of the outstanding options, 445,971 were exercisable as of March 31, 1993.

During fiscal 1993, the Company cancelled 464,097 options at $12.88 to $22.75 per share and reissued the same number of options at the then current fair market value of $10.25 per share with vesting restarting on the new grant date. Officers of the Company were excluded from participation in the option repricing.

Outside Directors Stock Option Plan. In April 1989, the Company established the 1989 Outside Directors Stock Option Plan, whereby outside directors may be granted non-qualified options to purchase common stock. Under this plan, 460,000 shares of common stock were authorized for issuance. The exercise price of the stock option may not be less than the fair market value of the common stock on the date of the grant. Generally, all options vest over a three year period. Each outside director is granted an option of 60,000 shares upon election to the Board and an additional 10,000 shares each subsequent year. As of March 31, 1993, 170,000 options are available for future grant and 192,500 options are outstanding, of which 102,500 options were exercisable at an average price of $8.27 per share.

Stock Purchase Plan. The Company has authorized 300,000 shares of common stock for issuance under the 1989 Employee Stock Purchase Plan. Employees may elect to withhold up to 10% of their compensation for the purchase of the Company's common stock. The amounts withheld are used to purchase the Company's common stock at a price equal to 85% of the fair market value of the stock on the first or last day of a six-month offering period, whichever is lower. The Company issued 80,542 shares at an average price of $9.99 per share in 1993, 56,980 shares at an average price of $7.01 per share in 1992 and 28,680 shares at an average price of $7.78 per share in 1991.

Stock Award Plan. In June 1989, the Board of Directors approved the 1989 Common Stock Award Plan and reserved 120,000 shares for issuance thereunder. Under this plan, awards are made to independent sales representatives and consultants based upon individual sales performance criteria. The shares are issued at fair market value and the related costs of the shares are charged to sales and marketing expense over the vesting period. The shares generally vest over three years and the Company can reacquire any unvested shares upon termination of the individual's relationship with the Company. As of March 31, 1993, the number of shares that have been awarded under this plan are 29,468, which are all fully vested.

As of March 31, 1993 the Company has the following shares of common stock reserved for future issuance:

1989 Stock Option Plan	3,000,192
1989 Outside Directors Stock Option Plan	362,500
1989 Employee Stock Purchase Plan	109,214
1989 Common Stock Award Plan	90,532
	3,562,438

8. Income Taxes

In February 1992, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." The Company has adopted the provisions of this Statement on a prospective basis in the first quarter of fiscal 1993 and the effect on its financial statements, upon adoption, was not significant. The Company paid approximately $3,935,000, $4,408,000 and $4,355,000 in income taxes in fiscal 1993, 1992 and 1991, respectively.

Income before provision for income taxes:	1993	1992	1991
Domestic	**$14,999**	$12,921	$10,896
Foreign	**239**	129	88
	$15,238	$13,050	$10,984

	1993	1992	1991
Provision for income taxes:			
Federal			
Current payable	**$ 5,336**	$ 3,602	$ 3,249
Deferred tax asset	**(1,476)**	(649)	(866)
Non-current deferred	**(221)**	542	236
Total Federal	**3,639**	3,495	2,619
State			
Current payable	**1,380**	1,019	848
Non-current deferred	**(163)**	—	7
Total State	**1,217**	1,019	855
Foreign	**97**	51	36
Total Provision	**$ 4,953**	$ 4,565	$ 3,510

The components of net deferred tax assets (which are included in prepaid expenses and deposits) are as follows:

	1993	1992
Deferred revenue currently recognized for tax purposes	**$2,432**	$1,068
Reserves and accruals not currently deductible for tax purposes	**1,368**	395
State taxes, not currently deductible for federal tax purposes	**301**	113
Depreciation	**578**	443
Other	**—**	1
Total deferred tax asset	**4,679**	2,020
Valuation allowance	**—**	—
Net deferred tax asset	**$4,679**	$2,020

The provision for income taxes differs from the amounts obtained by applying the federal statutory rate to income before taxes as follows:

	1993	1992	1991
Statutory federal income tax rate	**34.0%**	34.0%	34.0%
State income taxes, net of federal benefit	**5.7**	5.6	5.0
Permanent differences	**(7.2)**	(6.2)	(7.4)
Merger and acquisition costs	**—**	1.6	—
Other	**—**	—	0.4
	32.5%	35.0%	32.0%

To Network General Corporation:

We have audited the accompanying consolidated balance sheets of Network General Corporation (a Delaware corporation) and subsidiaries as of March 31, 1993 and 1992, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended March 31, 1993. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Network General Corporation and subsidiaries as of March 31, 1993 and 1992, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 1993 in conformity with generally accepted accounting principles.

As explained in Note 2 to the financial statements, the Company has given retroactive effect to the change in accounting for the sales value of customer support which is included as part of an initial warranty period.

Arthur Andersen & Co.

San Jose, California
April 23, 1993

BOARD OF DIRECTORS

Harry J. Saal
Chairman of the Board

Leslie G. Denend
President and Chief Executive Officer

Leonard J. Shustek
Network General Fellow

Dr. Howard Frank
Senior Fellow
Wharton School of Business

Gregory M. Gallo
Member
Ware & Freidenrich

Laurence R. Hootnick
President and Chief Executive Officer
Maxtor Corporation

OFFICERS

Harry J. Saal
Chairman of the Board

Leslie G. Denend
President and Chief Executive Officer

Riley R. Willcox
Vice President—Finance
Chief Financial Officer
Secretary

Peter Boot
Vice President—International Operations

Carl A. Goldman
Vice President—MIS and Manufacturing

Richard H. Lewis
Vice President—U.S. Sales

James L. Pante
Vice President—European Operations

LEGAL COUNSEL

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INDEPENDENT PUBLIC ACCOUNTANTS

Arthur Andersen & Co.
San Jose, CA 95110

TRANSFER AGENT

Chemical Trust Company of California is the transfer agent of the Company's common stock. Inquiries regarding lost certificates, change of address, transfer of ownership, or other stock account matters should be directed to: Chemical Trust Company of California, 50 California Street, 10th Floor, San Francisco, CA 94111, Tel: (800) 647-4273.

STOCK LISTING

Network General's common stock is traded on the NASDAQ National Market System under the symbol NETG. As of May 12, 1993, there were 582 stockholders of record.

DIVIDEND INFORMATION

Network General has never declared cash dividends and presently intends to continue this policy.

INVESTOR RELATIONS

Network General welcomes inquiries from its stockholders and other interested investors. To receive further information regarding the Company's operations, or to request copies of the 1993 Form 10-K, which is available at no charge, please contact: Investor Relations, Network General Corporation, 4200 Bohannon Drive, Menlo Park, CA 94025, (415) 473-2000.

UNITED STATES SALES OFFICES

Birmingham, AL; Phoenix, AZ; Santa Clara, CA; Anaheim, CA; San Diego, CA; Englewood, CO; Miami, FL; Atlanta, GA; Oakbrook Terrace, IL; Overland Park, KS; Edgewood, KY; Wakefield, MA; Minnetonka, MN; Chesterfield, MO; Davidson, NC; Hazlet, NJ; Rockville Centre, NY; Dayton, OH; Portland, OR; Carrollton, TX; Houston, TX; Alexandria, VA; Bellevue, WA.

INTERNATIONAL SALES OFFICES

Brussels, Belgium; Richmond Hill, Ontario, Canada; Paris, France; Dusseldorf, Germany; and distributors worldwide.

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